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DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA
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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER MARCH 10 2006
ISSUE

¶1. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- January Manufacturing Growth at 5.6%;
- December Retail Sales Strong; 2005 Sales Growth Decelerates;
- New Vehicle Sales Growth Leveling;
- Manufacturing Continues to Show Signs of Weakness;
- SACOB Business Confidence Falls in February
- Research Points to a Diverse Black Middle Class
- Lehmans Lowers Growth Outlook for South Africa; and
- Firms Begin to Feel HIV/AIDS Impacts on Work Force.

End Summary.

January Manufacturing Growth at 5.6%
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¶2. Statistics SA announced that January's growth in manufacturing production reached 5.6% (y/y), although it declined by 2.7% (seasonally adjusted) compared to the previous month's growth of 5.8%. Food and beverages and petroleum and chemical products explained most of the decline in production on a monthly basis. On a quarterly basis, manufacturing production increased 1.8% (seasonally adjusted) compared to the previous quarter. The strong rand continues to be a concern for export-intensive manufacturers, although strong international and domestic demand mitigates its effects. The IMF forecasts higher 2006 European growth at 1.2% y/y compared to 0.8% in 2005. In addition, the Southern African Development Community, South Africa's second largest manufacturing export destination, should grow by 5.9% from 4.8% in 2005, according to World Bank forecasts. Source: Statistics SA P3041.2, Standard Bank, Manufacturing Unpacked, March 9.

December Retail Sales Strong; 2005 Sales Growth Decelerates
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¶3. The 2005 holiday season showed strong consumer spending, though 2005 might be the beginning of a downward growth trend. Retail sales in December increased 8.9% (y/y) from November's growth of 7.9%, the highest growth in 8 months, according to Statistics SA. However, for 2005, yearly growth decelerated. Retail sales grew by 6.8% in 2005, from 4.9% and 9.7% in 2003 and 2004,

respectively. Consumer demand has been the main source of faster growth in the economy over the past couple of years, aided by the lowest interest rates in more than two decades, low inflation and the spending power of a rising black middle class. On a quarterly basis, real retail sales increased 8.1% (y/y). Source: Statistics SA Release P6242.1, March 8; Business Day, March 9.

New Vehicle Sales Growth Leveling
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¶4. The National Association of Automobile Manufacturers of SA (NAAMSA) released the February new vehicle sales showing growth may be decelerating in 2006. In February, new vehicle sales increased by 17.2% (y/y). February's growth is considerably lower than December 2005's growth of 27.4% and January's 20.3% growth. According to NAAMSA data, new vehicle sales increased by 25.7% in 2005, although strong growth in vehicle sales may not continue as a strong rand continues to affect exports in automobiles and other manufactured products. NAAMSA expects automobile growth to continue throughout 2006, although at a slower rate. Industry projections anticipate 10% growth for 2006. Auto production is the second-biggest industry in the manufacturing sector, which accounts for more than 16% of the economy. Vehicles comprise about 7% of South African exports. Source: Business Day, March 3.

Manufacturing Continues to Show Signs of Weakness
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¶5. Manufacturing activity contracted for the second consecutive month in February and, if sustained, could dampen South Africa's economic growth prospects. The



Investec Purchasing Managers' Index (PMI) reached 49 in February, slightly up from 48.1 in January. A reading below 50 suggests a contraction in the sector. In January, the PMI dropped below 50 points for the first time since October 2003, as the rand strengthened to a monthly average of R6.09 per dollar. The sustained strength of the rand explains much of the pressure on manufacturing, according Investec Asset Management's head of fixed income, Andre Roux. Since South Africa's growth in the past two years has been supported by strong increases in consumer demand, a slowing in consumer spending may mean lower overall growth. Argon Asset Management's Nazeem Hendricks expects a slowing in consumer demand as credit extension and money supply growth continue to level off. If manufacturing growth fails to accelerate, then overall South African growth expectations may have to be cut. Manufacturing employment also showed signs of weakness, with the seasonally adjusted employment index at 45.8, down from January's 46.7. Source: Business Day, March 3.

SACOB Business Confidence Falls in February
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¶6. According to the South African Chamber of Business (SACOB), South Africa's business confidence fell by 3 points to 100.1 in February, its biggest drop since October 2004. Apart from construction, the main growth area remains the service sector. SACOB noted that electricity, water services and government services were the weakest performers in 2005. According to SACOB economist Richard Downing, export volumes and manufacturing output are playing more important roles in affecting the business mood. Exports declined about 30% or R8billion during January, as imports rose by R3.5 billion. Source: Reuters, March 7; Business Day, March
¶8.

Research Points to a Diverse Black Middle Class

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¶7. A University of Cape Town (UCT) "Black Diamond" marketing survey study shows that the rapidly growing black middle class is more diverse than previously thought. The study, which confirms that the black middle class is the driving force behind South Africa's economic growth, investigated a range of issues, including the respondents' aspirations, attitudes and consumer behavior. The buying power of the black middle class is about R130 billion ($22 billion, using 6 rands per dollar) a year, approximately 15% of South Africa's 2004 household consumption. The study reports that black households in the upper income bracket [earnings of more than R154,000 ($26,000)] increased by 368% between 1998 and 2004. The survey did not reveal that affirmative action had led to frequent job changing. Only a small percentage of the respondents said they changed jobs more than three times in the last three years. The respondents were overwhelmingly confident about themselves and their futures, and reported that they had little interest in politics or overseas holidays. Relatively few are members of medical aid schemes or pension funds. Most of them say black economic empowerment has benefited only a privileged few and half feel trapped by rising debt. Although most respondents believe that moving out of the townships shows success, many still live in townships and have no plans to move. Tradition and custom remains important, with importance of lobola (payment for brides), ritual animal slaughter and ancestor worship continuing. The less affluent members of the black middle class spent more than their peers with higher incomes. Real wealth is concentrated mostly among those in the older, more established segment of the black middle class and they tend to invest rather than spend. The Black Diamond study listed unemployment as the biggest fear, registering higher than crime and HIV/AIDS. The "Black Diamond" marketing survey involved interviews with 750 adults living in metropolitan areas, selected from both suburban and township areas in Durban, Johannesburg and Cape Town, with an even gender split. Source: Sunday Times, February 26; Business Day, March 3.

Lehmans Lowers Growth Outlook for South Africa
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¶8. International investment bank Lehman Brothers lowered its 2006 gross domestic product (GDP) growth forecast for South Africa to 4% from 4.5%. Lehman revised its forecast because it expects the rand to remain strong due to rising global metals prices, leading to a possible manufacturing recession later in the year. Writing in the bank's Global Weekly Economic Monitor, Lehman Brothers' analyst Robert Beange noted that since November the price of gold had risen by 25% to around $560 per ounce. Lehmans calculated that the South African current account deficit would amount to 3.5% of GDP in 2006, thus leading to a sustained appreciation of the rand. Lehman Brothers' estimates suggested that the manufacturing sector could slip into recession during the second and third quarters of 2006. Lehmen Brothers also lowered its forecast for CPIX (headline consumer inflation less mortgage rate changes), with the current estimate of 4% by the end of 2006 compared to its previous projection of close to 5%. They expect the South African Reserve Bank to cut interest rates by 50 basis points at its April Monetary Policy Committee meeting. Source: I-Net Bridge and Business Report, March 6.

Firms Begin to Feel HIV/AIDS Impacts on Work Force
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¶9. According to Grant Thornton's 2006 International Business Owners Survey (IBOS), South African business

owners are increasingly starting programs to intervene against HIV/AIDS. Concern runs particularly high in the Eastern Cape cities of Port Elizabeth and East London, where 97% of the businesses surveyed reported a sizable impact on their business growth. The sectors showing the highest growth in concern were construction and retail, where the percentages increased to 87% and 88%, respectively, from 75% and 74% in 2005. Training proved the most popular element in companies' HIV/AIDS management plans, with 65% participating in these programs. However, only 35% of companies pay for employees' treatment costs. Lee-Anne Bac, the director of strategic solutions at Grant Thornton, said the extent of interventions increased compared to 2005, when the majority of business owners did not have any companywide policies. A study commissioned by AIC Insurance in 2005 showed that South Africa loses an estimated R12 billion a year due to absenteeism in the workplace, of which between R1.8 billion and R2.2 billion could be directly attributed to HIV/AIDS. In the mining sector, Harmony estimated costs related to HIV/AIDS would amount to 7.5% of total labor costs over the next 15 years, while its HIV/AIDS workplace program cost R10 million ($1.7 million) in the last financial year. AngloGold Ashanti spent R14.6 million ($2.4 million) in 2005 providing antiretrovirals, voluntary counseling and home-based care for terminally ill former employees, as well as research, monitoring and evaluation. Recently, the Epicenter AIDS Risk Management Foundation was appointed as consultant for a R2.4 million ($400,000) research project funded by the Global Fund for HIV/AIDS. The study will also examine the impact of the pandemic on the business sector, focusing on KwaZulu-Natal, which has been the hardest-hit province. The Grant Thornton IBOS Survey contacted 300 business owners who employ between 50 and 250 staff in South Africa. Source: Business Report, March 8.

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